

Discussion of “The Effect of Fiscal Policy Shocks on Asset Prices”

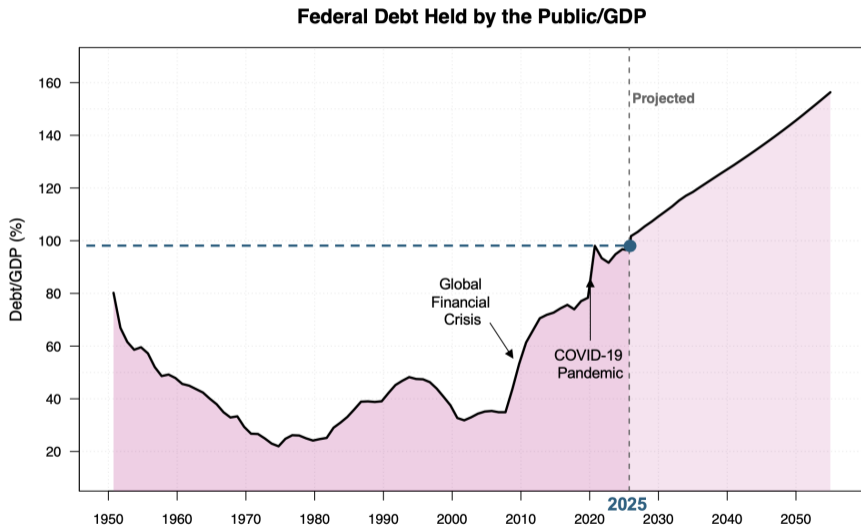
MFA 2026

Wenhao Li

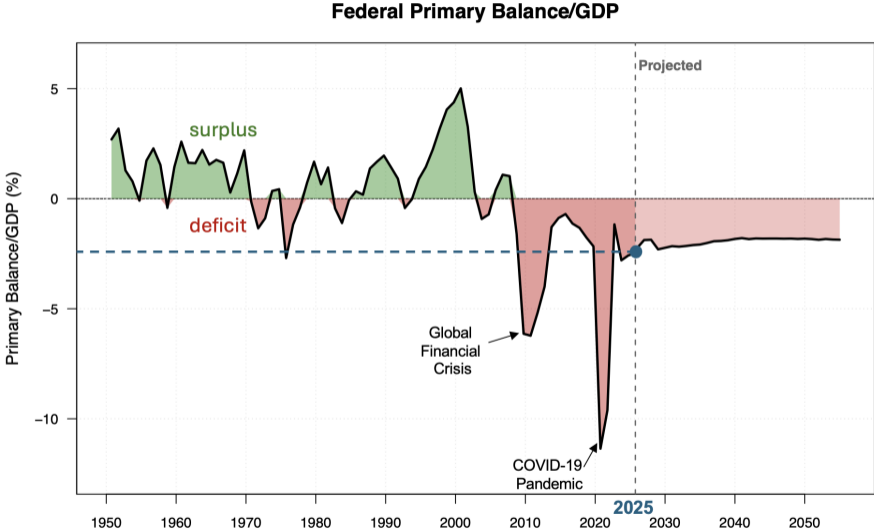
USC Marshall and NBER

March 2026

U.S. Debt Burden is Soaring



U.S. is Expected to Run Large Primary Deficits



Contribution: A Fiscal Policy Shock for Asset Prices

- **Monetary policy literature:** well-established notion of a *monetary policy shock* (e.g., Romer & Romer, high-frequency identification, narrative approaches).
- **Fiscal policy literature:** no widely accepted parallel notion of a *fiscal policy shock* for studying the effects on asset prices.
 - ▶ Low-frequency SVARs suffer from anticipation bias.
 - ▶ Narrative approaches require heavy subjective judgment.
- **This paper:** extracts a high-frequency, objective fiscal shock by following the Congressional budget paper trail and delivers a “fiscal shock” with precision comparable to a monetary policy shock.

U.S. Federal Budget & Approval Process

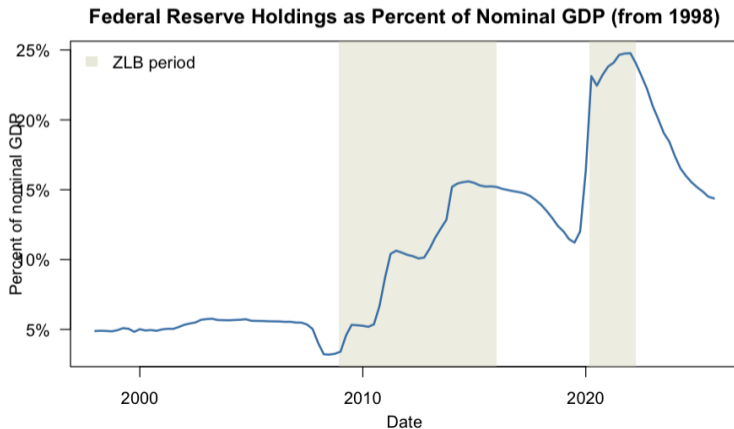
- **Mandatory (59%, ≈\$4.1T):** Social Security, Medicare, Medicaid. Major structural changes via **Budget Reconciliation** (simple majority, **51 votes**).
- **Discretionary (27%, ≈\$1.9T):** Defense \approx 13%, Non-Defense \approx 14%; appropriated yearly. Standard process + **60-vote filibuster** \Rightarrow gridlock and shutdown threats.
- **Net interest (14%, ≈\$1.0T):** Now $>$ \$1T; no annual vote.

Comments

- What is the mechanism of tamed response during ZLB periods?
 - ▶ ZLB results are confounded with recessions when inflation impact of fiscal stimulus is small and the Fed commits to lower rates via balance sheet expansions.
- When does fiscal information arrive?
 - ▶ Budget resolution stage: blueprint of overall fiscal policy, but not yet binding; discretionary spending not included.
 - ▶ Implementation stage: CBO scores of Congressional proposals, but most proposals are not passed.
 - ▶ Actual passage of individual bills: granular information, binding and enforceable, but no high-frequency information shock.
- How far are we from the classical fiscal equation?
 - ▶ Classical fiscal valuation: 100% passthrough of PV(primary surplus) to debt value.
 - ▶ This paper (from my calculation): 10% passthrough.
 - ▶ Open questions: Who is enforcing fiscal discipline in financial markets?

What is the Mechanism of Tamed Response of Yields in ZLB Periods?

- Q: Are the ZLB results about the ZLB or recessionary effects and Fed balance sheet expansions?
- Competing stories: (1) Inflationary impact of fiscal stimulus is small during recession dynamics; (2) Fed is more aggressive in absorbing government debt via QE during ZLB periods.



When Does Fiscal Information Arrive?

1. The “Planning” Stage (Budget Resolutions), used in this paper

- *Signal*: Blueprint of overall fiscal policy during budget resolutions.
- *Advantage*: aggregate budget information; political process generates shocks that are free from macroeconomic changes; quantity information is available.
- *Limitation*: Final enacted policy could differ; no granular bill-level information; some discretionary-spending and implementation-stage news are missed.

2. The “Implementation” Stage (CBO Scores of Proposals), used in Cram, Kung and Lustig (2025)

- *Signal*: High-frequency news around CBO evaluations for individual proposals.
- *Advantage*: Granular information; all proposals covering discretionary spending and emergency spending.
- *Limitation*: Captures noise from legislation that may die in committee (most proposals are not passed) and quantity information is not available.

Reference: Cram, Kung and Lustig (2025), Can Treasury Markets Add and Subtract?

When Does Fiscal Information Arrive?

3. The “Realization” Stage, used in Jansen, Li and Schmid (2026)

- *Signal*: Actual passage of individual bills. Granular information that is binding and enforceable.
- *Advantage*: binding and enforceable; all bills included; quantity information is available; viable for constructing macro states of fiscal expectations.
- *Limitations*: no high-frequency information and difficult to construct “shocks”.

Reference: Jansen, Li and Schmid (2026), Who Enforces U.S. Fiscal Discipline? Evidence from Government Debt Demand.

Debt value puzzle: Implied response to fiscal shocks is small

- Generalized fiscal equation:

current debt value = PV(expected primary surpluses) + others (safety/liquidity/bubble...).

- Table 10: a 1% increase in PV(expected deficits)/GDP raises yields by about 2 bps.
- **My calculation:** If Treasury duration is $D = 5$,

$$\frac{\Delta P}{P} \approx -5 \times 0.0002 = -0.10\%.$$

- If debt value is about 100% of GDP, then debt value falls by about **0.10%** of GDP when expected PV(primary surpluses) falls by **1%** of GDP.

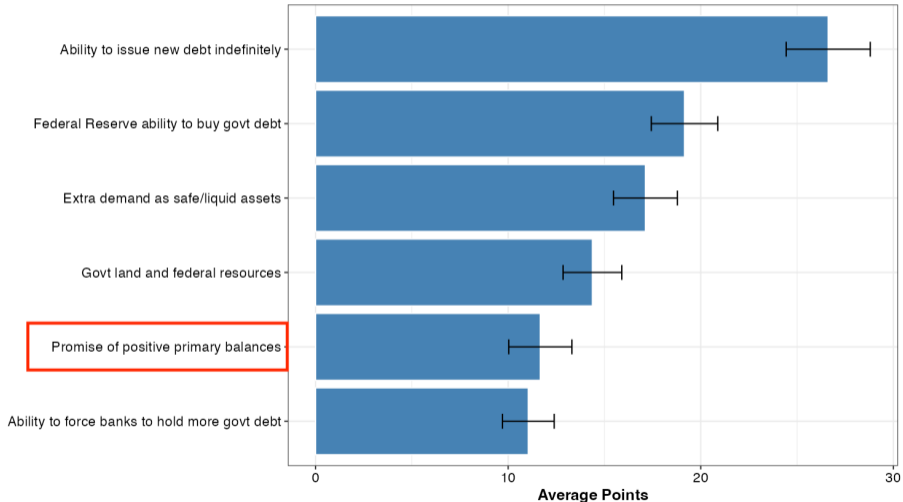
Small debt value response to fiscal surplus shocks

This implies only about **10% passthrough**: a \$1 decline in expected future primary surpluses reduces debt value by about 10 cents.

Why does U.S. government debt have value? Fiscal backing is small

Q8: What Backs U.S. Government Debt Value (100 Points)

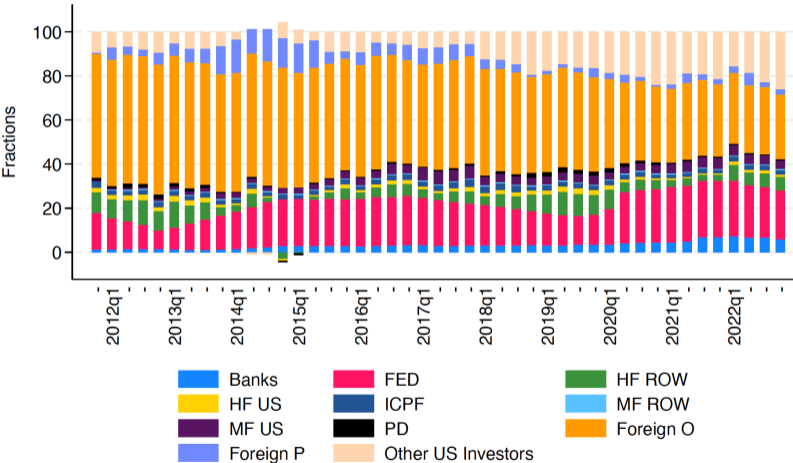
Aggregate across all survey runs (N = 554). Top 2 as stated; remaining points distributed equally across the o



Source: Delao and Li (2026), Beliefs of Government Debt Valuation and Sustainability.

Why fiscal response is low? Investor Composition may play a role

- Below I plot Treasury holdings for remaining maturities between 1Y and 5Y.



Source: Jansen, Li, and Schmid (2026), Granular Treasury Demand with Arbitrageurs.

Summary of Contribution and Implications for Future Research

- **Contribution:** High-frequency, objective fiscal shock from the budget paper trail; precision comparable to a monetary policy shock.
- Main Comments
 - ▶ Clarify the mechanism of how the Fed interacts with fiscal response.
 - ▶ When does fiscal information arrive? Budget resolution approach vs. bill-level approach.
- This paper opens the gate to many exciting and important new questions:
 - ▶ How to incorporate fiscal expectations into aggregate macro dynamics?
 - ▶ Who enforces the market response to fiscal news?
 - ▶ What determines government debt value and what is the role of fiscal dynamics?